

Kentucky Agriculture Finance Corporation

Meeting Minutes

August 8, 2003

The Kentucky Agriculture Finance Corporation met at 9:30 am on August 8, 2003 in the Old Capitol Annex in Frankfort, Kentucky.

Members Present:

Ms. Jane Jones; Ms. Sandy Ross; Dr. Harold Benson; Ms. Annette Crawford Walters; Mr. Wayne Hunt; Mr. Bob D. Proffitt; Commissioner Billy Ray Smith; Mr. Billy Hurd; Mr. Doug Lawson; Mr. Charles Miller

Members Absent:

Mr. Gordon Duke; Mr. Billy Joe Miles

Governor's Office of Agricultural Policy Staff Present:

David Bratcher; Gene Royalty; Bill McCloskey; Joel Neaveill; Edith Fultz

Guests:

Mr. Mark Farrow, General Council Kentucky Department of Agriculture
Ms. Ann Stewart, Kentucky Department of Agriculture
Jerry Roberts, OSBD/Governor's Office of Program Management
Blake Oliver, Community Farm Alliance

Commissioner Billy Ray Smith - announced that the press was notified of this meeting and asked the secretary to call the roll.

Commissioner Smith – welcomed everyone to the meeting and entertained a motion for approval of the Minutes of the June 13th meeting. Doug Lawson made a motion to approve; Billy Hurd seconded the motion. The minutes were approved.

David Bratcher – Introduced Butch Dunsmore from the Farm Service Agency (FSA)

Butch Dunsmore – Shared information on the Beginning Farmer Program. He explained that the Secretary of Agriculture initiated some programs which might help young people get started farming. He started by explaining that of all the money allocated for real estate loan programs, 70% is targeted for beginning farmers. In 1992 Congress passed a Federal State partnership program for beginning farmers. He

shared an information sheet with the group, explained the eligibility criteria and the two types of programs they offer.

Mr. Bratcher – asked if KAFC, since it is not a regulated depository institution, would be able to participate in the guarantee programs. Mr. Dunsmore responded that based on a conversation he had with FSA's legal department, as long as KAFC is audited with oversight and state entities are, FSA can approve the Corporation (KAFC) as a guaranteed lender. Mr. Bratcher explained that if KAFC can be the guaranteed party it should be able to sell the guaranteed portions of each loan, thus allowing funds set aside for the Young Farmers Program to be reused for other loans.

Mr. Dunsmore explained the need to work out the servicing of the loan. That could be done through contract, or KAFC could charge a servicing fee.

Mr. Hurd asked if all the other guidelines that banks follow on a guaranteed loan would apply. Mr. Dunsmore responded yes, the guaranteed program is still the same.

Mr. Bratcher explained that from a credit analysis standpoint, since FSA is going to be doing 40% of the financing and guaranteeing, a lot of the credit analysis is going to be done in Lexington. He added that the board's goal initially should be for a small staff thus raising an issue of how credit analysis will be done internally. KAFC obviously will need someone doing credit analysis, but this may not be a full-time position.

Ms. Walters questioned what is the minimum loan amount that could be sold in the secondary market. Sandy Ross responded that she has sold as little as \$50 thousand to as much as \$600 thousand to secondary market people. Mr. Bratcher asked if they are typically giving face value, more or less. Ms. Ross responded it could be done either way. She explained that if you take face value you're going to get more of a servicing spread. You could sell at a premium and get more money up front.

Mr. Lawson questioned if the FSA Down Payment Program should be targeted by KAFC since many commercial lenders would probably prefer to originate loans on their own in this program, unless there was a large amount of funding required. A customer meeting the 3-year minimum experience requirement with the 10% down payment and potential for a guarantee through FSA should be attractive enough to the lender and provide no role for KAFC. There was discussion with the general consensus being that the banks would see this as a good enough deal to take all of it. Mr. Dunsmore asked if there is a way KAFC could use some of their funds as incentive to make the whole 60% and give them an advantage that way.

Mr. Bratcher explained that the interest rate would be where our program would have some latitude but if part of our goal is to sell off the guarantee then the rate will need to be high enough to attract the investor, while still being low enough to aid the producer. Mr. Lawson expressed concern that we would have trouble finding an investor to buy the paper on a loan with a fixed rate at prime for 15 years. Mr. Bratcher asked whether we could still make the loan at prime, but not a fixed rate. He said this would still be a

better deal for the borrower. Mr. Lawson, Ms. Ross and Mr. Dunsmore offered comments on investors who want to buy guarantees.

Mr. Lawson commented that the Joint Financing Program seemed to better fit KAFC's objectives. Mr. Dunsmore told us the Joint Financing Program, although not included in the 1992 Act, could be included in the Memorandum of Understanding between FSA and KAFC. He described this program noting there is a 1% fee and a 90% guarantee with a maximum of \$762,000. Mr. Bratcher explained that our limit is imposed by statute and it has a maximum of \$250,000. Mr. Dunsmore explained that FSA's direct program does have limits of \$200 thousand dollars. He explained that they could not go over \$762 thousand with both direct and guarantee involved. Mr. Bratcher questioned how the group sees KAFC participating. Ms. Ross responded that it would be difficult to sell this to banks. There needs to be an incentive for the banks. There was group discussion on sharing the loans. Mr. Dunsmore told us that FSA will take second as they never have enough money to fill all of the loan requests.

Mr. Hunt asked how much money FSA has for this. Mr. Dunsmore told us that this year they have allocated \$1.2 million. Commissioner Smith commented that he understands that FSA has double the amount of applications as they have funds. Mr. Dunsmore responded, yes they have applications in Kentucky for \$15-\$20 million. Mr. Bratcher questioned whether FSA is getting enough applications for the Young Farmer program to use up that allocation. Mr. Dunsmore responded these applications are greater than 30%.

Mr. Dunsmore pointed out that if KAFC is considering being a guaranteed lender, the source of funds cannot be from tax-exempt bonds. Mr. Bratcher explained that this is not an issue as these funds are coming from the tobacco companies.

Commissioner Smith questioned whether KAFC would want to take a different approach and put the money in the Link Deposit Program. Mr. Lawson responded that this wouldn't roll our money back to us. He suggested that we go with a standard guarantee. There were further comments by the group supporting this.

Mr. Bratcher questioned Mr. Dunsmore as to whether there is more demand for the Young Farmer program in other states than in Kentucky. Mr. Dunsmore explained that the total allocation for this program nationwide is very small.

Commissioner Smith commented that the average farm in Kentucky is 159 acres and voiced concern of the qualifications of not more than 30% defeating the effort. Mr. Dunsmore told us that this hasn't been much of a problem and that most of the people in this group have been tenant farmers who want to become landowners. He explained that this has been raised to 35% and this is not what they are buying, but what they already own. Mr. Bratcher explained that this is something that would be beneficial to people in the tobacco-impacted counties. Mr. Dunsmore explained that FSA is not looking to help people who can go to lenders and get credit without their assistance. He

reiterated that they are not in competition with commercial lenders, they use whatever incentives they have to encourage commercial lenders.

Annette Crawford Walters asked if banks would be interested in us providing the \$250,000. Mr. Lawson offered a scenario of a group of farmers who want to form an LLC and put in a small processing plant that needs \$1.5 million. He asked if we are limited to the \$250,000 or can we make a guaranteed loan somehow. Mr. Bratcher read the definition - Prospective applicant must be a first time farmer as defined by the Federal Government who derives at least ½ of his annual gross income from said endeavor or business. He then asked Mr. Dunsmore if a group of established farmers who formed an LLC, which becomes new venture would qualify for FSA programs as first time farmers. Mr. Dunsmore responded yes, as long the entity is involved in production agriculture. He explained further. Mr. Bratcher asked for the distinctions between the B & I program and FSA's program. Mr. Dunsmore explained that B & I cannot be involved in production agriculture. They can finance the marketing aspect. Mr. Lawson commented that B & I are for much larger deals. There was further discussion.

Mr. Bratcher explained the Agricultural Investment Fund, which would work along the lines of the link deposit program. He told us that KAFC's biggest problem will be allocating a relatively small amount of funding, \$20 million, although the Corporation can ask for additional funding from the Agricultural Development Board and other sources.

Mr. Lawson asked the other bankers on the Board if they like the 60% - 40% split with KAFC doing the guarantee and the bank having the first mortgage. Mr. Hurd responded positively. Mr. Lawson explained further that if the bank were able to lend 60% of the request with a first mortgage and KAFC were lending the remainder subordinate to the bank, this could be attractive to the lender. KAFC's exposure would be limited to 10% of its loan since it had a 90% guarantee from FSA. Group discussion followed.

Mr. Bratcher questioned Mr. Dunsmore on how FSA handles it when they are asked to honor a guarantee. Mr. Dunsmore responded, when a problem occurs, the lender contacts FSA to let us know there is a problem, they would determine what their next servicing option is, whether they are going to restructure or liquidate the loan. In the event they choose to liquidate, they would submit a plan to us. FSA can pay an estimated loss claim until they get money up front. Once the account is liquidated and all proceeds are applied to the loan and there is still a balance, we would then pay a final loss claim.

Mr. Bratcher stated that we would want to have, in our inter-creditor agreement, a provision for cross defaults. He then asked what happens in the event of defaults, what does the lender have to do with the investor to whom they have sold the paper. Ms. Ross explained that the lender buys back prior to liquidation. Mr. Dunsmore stated that FSA would buy back if the lender didn't. There was group discussion.

Mr. Dunsmore stated that it is not hard to sell guarantee loans. He also explained that they have streamlined the application, particularly to those with preferred lender status. Mr. Bratcher asked how do you become a preferred lender. Mr. Dunsmore explained that you have to make several loans per year and they only have about 8 preferred lenders in the state. He told us that they have three categories, preferred, certified and standard.

Mr. Bratcher presented a letter that Governor Patton received from the Administrator of FSA in Washington earlier in the year, asking the states to enter into a MOU with FSA to do a partnership. Mr. Dunsmore addressed this telling us that they are encouraging states to work with them. He explained that the MOU is simple, saying that we agree to partner and cooperate with each other in providing joint financing. It only refers to the Down Payment Program, but he feels that it can be expanded to cover the Joint Financing Program. Nationally there is a push on for them to resolve this problem of the lack of young farmers coming into the business. Presently there are 16 states that have entered into an agreement with FSA. He added that he would like to see Kentucky involved. Mr. Bratcher offered comments and expressed a sense of general enthusiasm for moving in the direction of working with FSA in this arena. He suggested adopting a resolution that would allow us to move forward with this MOU and authorize Commissioner Smith, as our Chairman to sign it. Commissioner Smith entertained a motion to enter into this MOU with FSA and give him authority to sign. Harold Benson made the motion; Sandy Ross seconded the motion. There was group discussion with a vote to follow. The motion passed.

Mr. Bratcher offered an overview of how we see this program moving forward. He explained that he and Joel Neaveill met with the people from the Office of Financial Management this week. He told us that the Office of Financial Management oversees investments of state funds. They also have a master contract with Farmers Bank in Frankfort which allows state agencies to maintain accounts at Farmers Bank and wire transfer funds in and out. As a de jure municipal corporation, KAFC has the ability to maintain its own accounts outside of the state's accounting system. This will allow us a lot more speed than if we had to go through the State Treasurer to get the checks cut. He told us that Secretary Duke has requested that we use the Office of Financial Management to oversee the investments of KAFC funds. This still will provide some third party oversight to assure funds are being invested in a proper manner.

Commissioner Smith asked if we will still be subject to audit. Mr. Bratcher responded yes, and explained that we will have to write a letter to the State Auditor requesting an audit. He explained further and recommended that we go ahead with the agreement already in place between the Finance Cabinet and Farmers Bank so that we can get the program up and going.

Commissioner Smith recommended that we take action to authorize staff to move ahead with this. Doug Lawson made the motion; Charles Miller seconded. Ms. Walters asked for clarification. Mr. Bratcher explained that we would have a contract with the State Investment Commission, which is staffed by the Office of Financial Management.

The motion is to allow us to authorize Commissioner Smith, as the Chairman to execute an agreement with the State Investment Commission and if necessary an agreement with Farmers Bank. Commissioner Smith called for the vote. The vote carried.

Old Business:

Committee assignments were made.

- Audit - Annette Crawford Walters
 Doug Lawson
 Billy Hurd
 Wayne Hunt
 Sandy Ross
- Operations –
 Annette Crawford Walters
 Jane Jones
 Billy Hurd
 Bob Proffitt
 Harold R. Benson
 Commissioner Billy Ray Smith
 Charles Miller
- Marketing –
 Doug Lawson
 Jane Jones
 Charles Miller
 Bob Proffitt
 Harold R. Benson
 Wayne Hunt
 Sandy Ross
 Commissioner Billy Ray Smith

Mr. Bratcher offered clarification on committees. Commissioner Smith asked if the Operations Committee would oversee personnel. Mr. Bratcher stated that the Statute says that the Board may hire an Executive Director. He explained further that if the Board moves in that direction the Operations Committee would probably screen applicants and the full Board would make the hiring decision. Commissioner Smith commented that each of these committees would make recommendations to the full Board. Mr. Bratcher explained that these committees would be able to meet by conference call and there would not be a need for the committees to have open meetings.

Charles Miller commented about the Young Farmer program and questioned how we could sell this program. There was group discussion.

Mr. Bratcher suggested that we should have some tangible success stories between now and the beginning of the year to take to the General Assembly. He explained that

we are as vulnerable as the Governor's Office of Agricultural Policy's Agricultural Development Fund.

Commissioner Smith commented on High School FFA programs and the young and beginning farmer programs.

Mr. Hunt stressed the importance of moving quickly and stated that if we could set one or two functional industries in the heavily impacted areas right now it might mean the success of where this program could go. He offered further explanation.

Mr. Bratcher commented about the Phase II payments in comparison with a buyout. There was group discussion.

New Business:

Ms. Walters stated that if we find someone that is willing to come into Kentucky to buy our products we are not set up to do this and asked how soon can we get this ready.

Mr. Bratcher asked Mark Farrow for explanation of the regulatory scheme in Kentucky and what we have to do.

Mr. Farrow explained that we have the authority to promulgate regulations but it has not been mandated that we do so. He handed out a timeline of what the regulatory process is, under normal conditions. He explained that there is an emergency process but doesn't feel that we have any situation that would allow us to fit in as an emergency. He explained this timeline in detail.

He explained that the urgency of doing regulations is probably gone because KAFC operates under statute and can do most of the things it wants or needs to do. He suggested that we would probably want to do some administrative regulations at some time to provide continuity for the policies and procedures this board may develop. Mr. Bratcher asked Mr. Farrow if the board could continue to operate under guidelines if they are in the process of developing regulations. Mr. Farrow responded, yes and explained further. There was group discussion.

Commissioner Smith asked what would the opinion of the Legislative Committees be, in trying to restructure our organization and go with HB541. Would they want to see HB541 change first then put the administrative regulations in place that will go along with HB541, and suggested that this is what we would want? Wayne Hunt concurred. Mr. Farrow agreed with Commissioner Smith and Mr. Hunt on getting the changes made as quickly as possible, early in the session then look at doing regulations. Commissioner Smith suggested that we go ahead and pre-file that bill and get the emergency clause on it. There was further discussion.

Mr. Bratcher explained that if the Board decides today to move forward with guidelines we could go ahead. Once we get our contract with the Agricultural Development Board we are ready to do business. We could be ready to go by October.

Mr. Farrow stated that this Board has a lot of guideline decisions to make. Mr. Bratcher responded that guidelines will be the primary topic of next month's meeting. He also pointed out that by having guidelines we have the opportunity to make changes in the event that we may need to. He explained further. There was group discussion.

Mr. Bratcher commented that there is a one-page regulation that was promulgated back in the mid 80's to establish a revolving loan fund for operating loans that was initially capitalized to the extent of \$500,000. There is question whether the \$500,000 is still intact. Mr. Roberts agreed to determine if the funds still were available.

Mr. Hunt made comments and stated that we need to sell this program. Mr. Bratcher offered the Green River cattle company and the goat milk project as examples of groups that will need our services. There was further group discussion.

Mr. Bratcher explained that over the last two years the ADB has made some loans. Some are forgivable loans. He offered examples with explanation of the requirements for forgiveness of the loans. He explained that at some point the ADB might want the KAFC to take over some of the loans. He explained further.

Mr. Bratcher handed out copies of the actual write-up given to the ADB for review at their July meeting. He explained the process and asked the KAFC Board to review the terms and conditions. He offered further explanation regarding the Revolving Loan Fund program and the request by the ADB for the KAFC to manage the process. He told us that he has provided a copy of the grant guidelines that will be acted upon this month by the ADB. Whether we will have counties that take advantage of this remains to be seen.

Commissioner Smith added that some counties have had trouble coming up with projects. The model programs give them ideas and this is another resource they can use. He mentioned Mr. Hunt's comments to the Oversight Committee that we could make a variable interest rate, suggesting that the more tobacco dependent counties could have a lower rate. Mr. Bratcher explained that the local Councils would determine the rate.

Mr. Hunt offered examples of how we might help heavily impacted counties. Mr. Bratcher added that it is up to the locals to determine the rules. What we have attempted to do is leave the credit decision to the banks for various reasons.

Ms. Walters asked why a prudent loan officer would want to defer a payment for 5 years. Mr. Bratcher responded that he doesn't know why and added that it is in there. Jane Jones asked if the Fund for Agriculture is just for real estate, or if we fund the plant can we also fund the operating expenses. Mr. Bratcher explained that we can and

offered examples. He gave further explanation and expressed that our goal is to try to make money for the corporation so we can have more money to lend and also pay our operating expenses.

Ms. Walters stated that our application does limit us to \$125,00 and asked if we should change that. Mr. Bratcher responded that we could go back and ask the ADB to add an amendment.

Doug Lawson brought up the application process to get a FSA lending paper. KAFC should start that process. Mr. Bratcher entertained a motion to allow Commissioner Smith to sign that application. Doug Lawson made the motion; the motion was seconded. The motion passed.

Next Meeting Date:

The next meeting is scheduled for 9:30 am on September 12, 2003

Adjourn:

The meeting adjourned at 12:00pm